February 28, 2003

Luly E. Massaro, Commission Clerk
R.I. Public Utilities Commission
89 Jefferson Blvd.
Warwick, RI 02888

RE: Narragansett Electric Company Request for Approval and Corresponding Rate Treatment for Standard Offer Supply Contract Amendment – Request for Confidential Treatment

Dear Ms. Massaro:

Enclosed on behalf of The Narragansett Electric Company ("Narragansett" or "Company") is an amendment to Narragansett's Standard Offer supply contract with one of its current Standard Offer suppliers (the "Amendment"). Like other supplier contracts executed by the Company, the terms of the proposed Amendment, including the identification of the supplier, are considered proprietary, commercially sensitive and confidential. Thus, in accordance with Rule 1.2(g) of the Commission's Rules of Practice and Procedure, the Company respectfully requests confidential treatment of this Amendment. A complete copy of the Amendment is enclosed in a sealed envelope marked as "Privileged and Confidential Materials – Do Not Release". A copy of the Amendment has also been provided to the Division and to the Attorney General. Also included in this package is a confidential analysis comparing the costs incurred under this Amendment to other potential alternatives.

In addition, a copy of the original agreements with this supplier, executed in 1998, (the "Original Agreements") has also been provided to aid the Commission in its review. As with the Amendment, the Original Agreements are considered proprietary, commercially sensitive and confidential and the Company requests confidential treatment of these documents as well. Copies of redacted, "public" versions of both the Amendment and the Original Agreements will be filed with the Commission as soon as they become available.

By this filing, the Company is requesting approval from the Commission to include in its Standard Offer Adjustment Provision the additional costs that would be incurred under the proposed Amendment. The Company is estimating that the Amendment would result in an increase of $2.8 million per year over the price that Narragansett presently pays under the Original Agreements with this supplier based on calendar year 2002 Standard Offer loads. This equates to an increase in typical 500 kWh residential bills of 23 cents per month or about 0.4 percent. It is important to note

at the outset that, in the absence of this Amendment, the Company and its customers may incur even greater costs.

Background

The Amendment was executed on January 27, 2003 with a pre-existing Standard Offer supplier that provides a portion of the Standard Offer power requirements for the former Blackstone Valley Electric Company and Newport Electric Corporation (the "EUA Companies"). As successor in interest to the EUA Companies by reason of merger on May 1, 2000, Narragansett purchases Standard Offer supplies under the terms of the Original Agreements executed in 1998.

The Original Agreements contain unique language not found in any of the Company's other Standard Offer agreements. The Company refers the Commission to the terms of the Agreement and, in particular, Article 3, paragraphs 2 and 5, and the defined terms therein. Under the present NEPOOL pricing scheme, costs to both the supplier and the Company were clearly delineated under these provisions. However, with the implementation of ISO's Standard Market Design ("SMD") and locational marginal pricing ("LMP") scheduled to go into effect on March 1, 2003, the Company and the supplier had different interpretations of their respective obligations under the Original Agreements. Under the supplier's interpretation, in reliance on language unique to this supplier's agreement, the supplier would have flexibility to deliver to any point on the NEPOOL PTF System without incurring any additional congestion cost, thereby leaving the Company and its customers to bear the incremental congestion cost burden. As discussed below, Narragansett is unable at this time to predict, with certainty, the magnitude of congestion costs to which it might have been exposed were the agreement to be interpreted to permit the supplier to have delivery point flexibility.

It is important to note that while transmission delivery points in Rhode Island are not expected to incur any significant congestion costs, they are also not likely to be the lowest cost delivery points or "nodes" on the NEPOOL PTF system. Thus, absent the amendments, a supplier may have sought to deliver the power at the lowest cost delivery points available to it anywhere within New England. As the Company's analysis shows, it is possible that, absent the Amendment, the supplier might seek to deliver to a node in Rhode Island that has a lower energy clearing price than the Rhode Island zonal price and thus congestion costs could be incurred even if power is delivered in Rhode Island. In addition, the NEPOOL rules allow a supplier to specify the delivery location after the dispatch day. Thus, if the Original Agreements were construed such that Narragansett must bear congestion costs, Narragansett would also be unable to effectively mitigate its congestion cost exposure. Because both parties recognized the differing interpretations, and the supplier could better mitigate congestion cost exposure, the parties negotiated the proposed Amendment. Narragansett believes that this Amendment mitigates the uncertainty and the litigation risk in a least-cost manner and, accordingly, the Amendment is in the best interests of customers.

The Proposed Amendment

Under the proposed Amendment, Narragansett will pay an additional fee to the supplier, fixed on a per-kWh basis, in exchange for the supplier's agreement to deliver Standard Offer supplies directly to Narragansett's load centers. See Paragraphs 3 and 5 of the Amendment. The supplier would bear any congestion cost required to meet its delivery obligation. This Amendment will not become effective unless Commission approval is first received to include these costs as part of the overall supply costs included in Narragansett's Standard Offer Adjustment Provision. Finally, if Commission approval is not received by June 27, 2003, the Amendment will terminate by its own terms.

Although the Company has the option to continue service under the Original Agreements, we believe that the proposed Amendment is in the public interest for two primary reasons. First, the Amendment caps customer exposure to upside congestion cost risk because the fee charged is fixed on a per kWh basis and cannot increase during the term of the Original Agreements (through 2009). As mentioned above, it also puts the cost risk on the party most able to mitigate that risk.

Second, based on the Company's analysis, the supplier has agreed to bear the congestion cost risk at a reasonable price. Although an LMP system has not yet been implemented, indicative locational marginal prices recently published by the ISO show the expected price difference between over 40 locations in New England, including Rhode Island, and the Company's load zone in Rhode Island is well in excess of the cost proposed to be paid to the supplier under the Amendment. This reasoning is also supported by independent price quotes sought by Narragansett and its affiliates from other independent suppliers. The available price quotes were at a price that was more than double the amount being sought by the Company's supplier. A summary of these analyses is provided in confidential attachments included with this filing.

Basis for Recovery of Costs

Although approval of the proposed Amendment is technically subject to Federal Energy Regulatory Commission ("FERC") jurisdiction, Narragansett and its supplier have agreed that the Amendment will not become effective unless the Company receives approval from this Commission to include its costs as part of Narragansett's Standard Offer Adjustment Provision. Under the Rhode Island General Laws, the Company is entitled to recover "costs incurred from providing the standard offer arising out of: (1) wholesale standard offer supply agreements with power suppliers in effect prior to January 1, 2002; [or] (2) power supply arrangements that are approved

by the commission after January 1, 2002…" RIGL 39-1-27.3 (b). Narragansett requests Commission approval to recover its costs from this Amendment as described in subsection (2) above. If the Commission does not approve cost recovery under the Amendment, Narragansett would be at risk of incurring congestion costs under the Original Agreements that would be recoverable under subsection (1) above. Accordingly, the Company believes that this is not a matter of whether cost recovery is available under the Standard Offer Adjustment Provision, but rather on what basis it is preferable to incur the additional costs.

Further, recovery of costs under the proposed Amendment would not require any modification to the Company's presently effective Standard Offer Adjustment Provision. Under the terms of that Provision, the Standard Offer Rate is "subject to adjustment to reflect the power purchase rates incurred by the Company in arranging Standard Offer and Last Resort Service…"

Conclusion

For the reasons discussed above, the Company respectfully requests Commission approval to include the costs set forth in the enclosed Amendment as part of its Standard Offer Adjustment Provision. We stand ready to supply any additional information the Commission may need in support of this request.

Thank you for your attention to our filing. Please contact me if you have questions concerning this matter.

Very truly yours,

Terry L. Schwennesen
General Counsel

Cc: Paul Roberti, Esq.
Steve Scialabba